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Appraisal is Often Best Remedy for Claim Disputes

By Jonathan D. Mutch | June 20, 2005

When Valuation is at Issue, Appraisal Can Save Money and Time

As someone who makes his living by representing people who sue each other, it may sound odd for me to say, but it's true–a lawsuit is not the answer to every dispute.

A case in point is a typical dispute over the amount of an insurance claim resulting from the loss of property. Using appraisal instead of a lawsuit can often save time and money for both the claimant and the insurance carrier.

Appraisal (also called "reference") is a fair and efficient way to settle most valuation disputes. It is a contractual remedy, binding on both parties, that either the claimant or the carrier can demand. It can only be applied to valuation disputes, not coverage issues. When coverage issues are being disputed, however, appraisal can still be used to address valuation issues, even if the coverage disagreement results in a lawsuit.

Appraisal can be used in virtually any valuation dispute. We've been involved in appraisals ranging from relatively mundane disputes up to losses resulting from the terrorist attack on the World Trade Center.

How appraisal works

The point of appraisal is to value the loss. Valuation depends on how the insurance policy is written. It may be based on actual cash value or replacement cost, for example. Business interruption (or "time element") losses can also be measured by appraisal.

The insurance policy language covering appraisals is usually straightforward and routine. In some cases, it is drawn from a state's statutory standard fire policy. Since the same language applies to both the claimant and the carrier, it does not favor one party over the other. Everyone has to live by the same rules.

The insurance policy lists the requirements for demanding appraisal. While policy language may vary somewhat, typically either party may demand appraisal when there is (1) a failure to agree on the amount of a loss, and (2) a written demand for appraisal is tendered by either party.

Appraisal takes place before a three-member panel consisting of one appraiser for each party, plus an umpire chosen by the two appraisers. The umpire resolves disagreements between the party appraisers. If the appraisers cannot agree on an umpire, a court selects one.

Having a three-person panel decide valuation disputes is quicker and less expensive than involving a judge and jury for several reasons. Not only are fewer people involved, but the panel typically consists of three seasoned professionals. They can quickly come up to speed on valuation issues with far less need for the involvement of attorneys or expert witnesses.

In addition, appraisal panels can establish their own procedures. Litigation is highly structured–rules of evidence and rules of procedure must always be followed. In contrast, the appraisal panel has few rules of procedure to follow and is not bound by formal rules of evidence. As long as two of the three panel members agree, the panel can decide what it wants to do and what it wants to hear. While the appraisal panel has flexibility, it also has limitations. It cannot address legal issues. Its sole purpose is to address valuation. An award in writing, signed by two panel members, settles the valuation dispute.

Small appraisals often take place without either party involving an attorney. For larger cases, attorneys usually help find candidates for serving on the panel, take depositions or examinations under oath, and prepare experts for the appraisal hearings

When one party doesn't want appraisal

While appraisal is typically beneficial to both parties, one party may fight appraisal when the party believes that a jury will act more favorably. Those who have never been through appraisal before may also be hesitant to go along, because they are uncertain about trying something new. A typical approach is to argue that the other party waited too long before requesting appraisal, thereby "waiving" (i.e., abandoning) its contractual rights.

How long is too long to wait? It depends, as the following two cases involving arguments of waiver demonstrate.

Chainless Cycle: One early case that is still often cited began when a fire loss at a manufacturing facility damaged Chainless Cycle's bicycle parts. A participating insurer and an adjuster retained by the insurer ignored the manufacturer's requests for appraisal.

Rust and decay were reducing the value of any salvageable goods. The insured and the adjuster finally reached a verbal agreement on the amount of loss. Based on the verbal agreement, the policyholder sold a substantial percentage of the goods.

Days later, the insurer refused to settle at the amount agreed to by its retained adjuster, arguing that the adjuster acted without authority. At that time, the insurer demanded appraisal, even though it knew many of the goods had been sold and over a year had elapsed since the loss. Ignoring the appraisal demand, Chainless Cycle initiated a lawsuit. The insurer argued that the lawsuit was improper and premature because of its appraisal demand.

New York's highest state court found that the insurer waived its right to demand appraisal. Applying a standard still current today, the court said that appraisal must be sought within a reasonable time. While the standard does not provide a definite or fixed time in which appraisal must be demanded, in this case the insurer failed to meet the standard because it tried to misuse the appraisal process.

Terra Industries: The opposite outcome was reached in a more recent case involving Terra Industries, even though two-and-a-half years passed before the insurer requested an appraisal (Disclosure: Robins, Kaplan, Miller & Ciresi LLP represented the insurer in this case).

The Terra Industries case, which involved many complex issues, resulted from an industrial explosion that caused claimed damages exceeded $360 million. The parties exchanged loss information and negotiated for a long time. Ultimately, after an impasse was reached, the insurer sought appraisal.

Even though more than two-and-a-half years had passed since the explosion, the court rejected the insured's claim of waiver. The court found that the parties had tried to agree on the amount of loss before the insurer demanded appraisal, and that the size and complexity of the loss made the delay reasonable.

There are no set rules about exactly when appraisal must be demanded–it is a window in time, not a specific point. Courts considering a claim of waiver define the edges of the window by reviewing the facts of each case. The reason for a waiver must be compelling for a court to deny a party its contractual right to appraisal.

Given that an appraisal can be readily implemented, that it costs less than a trial, and that it can often be completed within a short time, in practically any valuation dispute, appraisal is worth … appraising.

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